(24)

IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1941.

3145.661

JAMES C. JONES,
Petitioner,

vs.

GUY T. HELVERING, Commissioner of Internal Revenue,
Respondent.

No. 565

PETITION FOR WRIT OF CERTIORARI

To the Circuit Court of Appeals
for the Eighth Circuit
and

BRIEF IN SUPPORT THEREOF.

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PETITION FOR WRIT OF CERTIORARI

to the Circuit Court of Appeals for the Eighth Circuit.

James C. Jones prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Eighth Circuit.

The judgment of the Court of Appeals was entered on June 24, 1941 (R., p. 31).

The petition for rehearing was denied on July 23, 1941 (R., p. 41).

QUESTION PRESENTED.

Where the taxpayer (petitioner herein) purchases real estate subject to an existing mortgage which the taxpayer did not execute and did not assume or agree to pay, and

Where it is stipulated by the parties hereto and found by the Court as a fact that when the mortgage note became due the taxpayer's equity in the property was worthless because the value of the property was less than the amount of the mortgage note, and

Where the taxpayer (petitioner herein) determines to abandon the property on the date when the note falls due and permit the holder of the mortgage to foreclose, and

Where thereafter the holder of the mortgage does foreclose,

Does the loss sustained by the taxpayer (petitioner herein) result from the mortgage foreclosure sale, or is it an ordinary loss resulting from the depreciation of the property because of a change in business conditions?

STATEMENT OF THE CASE.

The case originated before the Board of Tax Appeals. The Commissioner (respondent herein) contended that the taxpayer sustained a capital loss, and the petitioner herein contended that the loss sustained was an ordinary loss.

The Board of Tax Appeals ruled the case in favor of the petitioner. Respondent appealed to the Circuit Court of Appeals, which reversed the Board and held that the loss was a capital loss.

The facts were stipulated and were found by both the Board of Tax Appeals and the United States Circuit Court of Appeals to be in accordance with the stipulation. These facts as found are, briefly:

On February 11, 1931, petitioner purchased certain real estate in St. Louis, Missouri. The purchase price was $35,400. At the time of the purchase there was a deed of

trust on the property in the amount of $15,000, and the balance of the purchase price, namely, $20,400, was paid by petitioner. The deed of trust was neither executed nor assumed by petitioner. The property was purchased subject to the deed of trust.

When petitioner purchased the property it was rented and the income therefrom was $160 per month. Shortly thereafter property values in the neighborhood deteriorated and the tenant refused to continue the payment of $160 per month. In August, 1931, respondent leased the property for a period of two years from September 15, 1931, to September 14, 1933, at a rental of $135 per month. In February, 1933, the rent was reduced to $115 per month. This amount of rent was collected until the end of the term of the lease in September, 1933.

Upon the termination of the lease the property became vacant and petitioner was never able to secure another tenant.

When the deed of trust became due on January 27, 1935, petitioner determined that his equity in the property was worthless. He refused to pay, and did not pay, the taxes for the year 1934. He determined to abandon the property and permit the holder of the deed of trust to foreclose.

The stipulation of facts recites:

> "At that time (January 27, 1935) business conditions had so completely changed in that particular locality that taxpayer's equity in the property was of no value."

The property was sold by the trustee named in the mortgage under the terms of the mortgage in foreclosure on March 16, 1935, and the price obtained at the sale was $10,000. The property was neither purchased by the peti-

tioner nor by the holder of the note secured by said mortgage.

The taxpayer (petitioner herein) not only lost his entire investment of $20,400, but the holder of the mortgage note lost $5,000 by reason of the loan on the property.

REASONS FOR THE ISSUANCE OF THE WRIT.

The decision of the United States Circuit Court of Appeals for the Eighth Circuit is in conflict with the decisions of the United States Circuit Courts of Appeals of other Circuits in the following cases:

Commissioner v. Freihoffer, 102 F. (2d) 787 (C. C. A. 3);
Commissioner v. Hoffmann, 117 F. (2d) 987 (C. C. A. 2);
Schmidlapp v. Commissioner, 96 F. (2d) 680 (C. C. A. 2);
Commissioner v. Coggan, 119 F. (2d) 504 (C. C. A. 1).

Respectfully submitted,

LON O. HOCKER,
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Attorneys for Petitioner.

BRIEF IN SUPPORT OF PETITION.

OPINION BELOW.

The opinion of the United States Circuit Court of Appeals for the Eighth Circuit may be found in the record at page 25.

JURISDICTION.

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1935.

QUESTION PRESENTED.

The question presented is stated in the petition, and it may be briefly restated here as follows:

Can a taxpayer sustain a loss from the sale of an asset which the Court found to be worthless prior to the date of the sale?

STATEMENT.

The facts and reasons relied on for the issuance of the writ and the statement of the case appear in the petition.

ARGUMENT.

The facts in the case were stipulated and both the Board of Tax Appeals and the United States Circuit Court of Appeals for the Eighth Circuit found the facts to be in accordance with the stipulation entered into by the parties hereto.

The court below found as a fact that at the time the mortgage note became due petitioner's interest in the property was of no value. The Court made the finding in paragraph 3 of its opinion in the following language:

> "At that time (January 27, 1935) business conditions had so completely changed in that particular locality that taxpayer's equity in said property was of no value."

This finding of fact fixes petitioner's loss as of that date and attributes that loss to a change in business conditions. After that date no gain or loss could be recognized from an attempted sale of the capital asset, because that asset was worthless and could not be sold.

The mortgage foreclosure sale which took place on March 16, 1935, was of no tax significance so far as the rights of this taxpayer (petitioner herein) are concerned. The loss had occurred, according to the finding of the Court, on January 27, 1935, and petitioner could not sustain any loss from the mortgage foreclosure sale.

The court below erroneously held that petitioner's loss was a capital loss and resulted from the foreclosure sale. This ruling of the United States Circuit Court of Appeals for the Eighth Circuit is not only erroneous, but is in direct conflict with decisions in other circuits in the following cases:

> Commissioner v. Freihofer, 102 F. (2d) 787 (C. C. A. 3);

Commissioner v. Hoffman, 117 F. (2d) 987 (C. C. A. 2);
Schmidlapp v. Commissioner, 96 F. (2d) 680 (C. C. A. 2);
Commissioner v. Coggan, 119 F. (2d) 504 (C. C. A. 1).

In the case of Commissioner v. Freihofer, 102 F. (2d) 787 (C. C. A. 3), the facts are identical with those in this case. In the Freihofer case the taxpayers had purchased real estate which was subject to a mortgage exactly as was done in this case. The Court found at the time of the mortgage foreclosure sale that the taxpayers' equity had become worthless, just as the Court found in this case. In the opinion the Court of Appeals for the Third Circuit said:

> "The taxpayers' losses resulted from the fact that their equities had become worthless and not from the sale of those equities. One cannot sell what has wholly disappeared. Consequently the foreclosure sales had no reality as sales so far as the taxpayers' equities of redemption were concerned. * * *
>
> "It follows that while the foreclosure sales were undoubtedly the identifiable events which pointed out the worthlessness of the taxpayers' equities, they did not cause the losses, and consequently the provisions of Sec. 117 do not apply."

In the case at bar the foreclosure sale was not the identifiable event which pointed out the worthlessness of petitioner's equity. This was not necessary, because it was stipulated by and between the parties hereto that petitioner's equity was of no value as of January 27, 1935, while the mortgage foreclosure sale did not take place until March 16, 1935. Both the petitioner and the respondent agreed and stipulated that prior to the foreclosure sale petitioner's equity was worthless. The Court found the facts to be in accordance with such agreement and stipula-

tion, and consequently no loss could be sustained by petitioner by the mortgage foreclosure sale, which took place at a later date.

In the case of Commissioner v. Coggan, 119 Fed. (2d) 504 (C. C. A. 1), the Court of Appeals for the First Circuit said:

> "The taxpayer now urges that the stock had become worthless prior to the sale at public auction. Under the 1934 Act securities which had become utterly worthless could be charged off as an ordinary loss during the year in which they became worthless."

Now, in the case at bar, the real estate which had become worthless prior to the mortgage foreclosure sale could be charged off as an ordinary loss and the taxpayer did not suffer a further loss by reason of the mortgage foreclosure sale.

In the case of Commissioner v. Hoffman, 117 F. (2d) 987 (C. C. A. 2), the Court of Appeals for the Second Circuit said:

> "The Commissioner seeks reversal of a decision of the Board holding that under Section 23 (e) (2) of the Revenue Act of 1934 the taxpayers were entitled to deduct from gross income a loss sustained in 1934 when the interest in improved real estate owned by them subject to a mortgage, upon which they had not assumed liability, became worthless and they abandoned their interest and so advised the mortgagee; although title remained in them until completion of foreclosure proceedings in the following year. Upon amply sufficient evidence the Board found specifically that the taxpayers' interest in the property became worthless in 1934. We see no valid ground to differentiate between a loss suffered on real estate and one on personalty, if worthlessness is definitely established."

In view of the fact that the decision of the United States

Circuit Court of Appeals for the Eighth Circuit in this case is directly in conflict with decisions of the United States Circuit Court of Appeals for the Third Circuit, the United States Circuit Court of Appeals for the First Circuit and the United States Circuit Court of Appeals for the Second Circuit, we respectfully submit that this petition should be granted.

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Statutes:

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Miscellaneous:

Treasury Regulations 86:

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414031—41

In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 565

JAMES C. JONES, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the United States Board of Tax Appeals (R. 11–13) is unreported. The opinion of the Circuit Court of Appeals for the Eighth Circuit (R. 24–29) is reported in 120 F. (2d) 828.

JURISDICTION

The decree of the Circuit Court of Appeals was entered on June 24, 1941 (R. 29), and the order denying a petition for rehearing was entered on

July 23, 1941 (R. 41). The petition for a writ of certiorari was filed with this Court on August 29, 1941. Jurisdiction is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

When a taxpayer, who owns premises subject to a mortgage which he did not assume, permits the property to be foreclosed because the value of the property has fallen below the amount of the mortgage, is the loss a capital one subject to the limitations of Section 117 (d) of the Revenue Act of 1934, or is it an ordinary loss allowable in full under Section 23 (e) of the Revenue Act of 1934?

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1934, 48 Stat. 680:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—
>
> (1) if incurred in trade or business; or
>
> (2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or
>
> (3) of property not connected with the trade or business, if the loss arises from

fires, storms, shipwreck, or other casualty, or from theft. No loss shall be allowed as a deduction under this paragraph if at the time of the filing of the return such loss has been claimed as a deduction for estate tax purposes in the estate tax return.

* * * * *

(U. S. C., Title 26, Sec. 23.)

SEC. 117. CAPITAL GAINS AND LOSSES.

* * * * *

(d) *Limitation on Capital Losses.*— Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. * * *

* * * * *

(U. S. C., Title 26, Sec. 101.)

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 23 (e)–1. *Losses by individuals.*— * * *

In general losses for which an amount may be deducted from gross income must be evidenced by closed and completed transactions, fixed by identifiable events, bona fide and actually sustained during the taxable period for which allowed. Substance and not mere form will govern in determining deductible losses. Full consideration must be given to any salvage value and to any insurance or other compensation received in determining the amount of losses actually sustained. See section 113 (b).

STATEMENT

The facts were stipulated (R. 9–11) and found by the Board of Tax Appeals as stipulated (R. 12–13). They may be summarized as follows:

In 1931 the taxpayer purchased certain real estate in St. Louis, Missouri, for $35,400. At the time of the purchase there was a deed of trust on the property in the amount of $15,000, and the balance of the purchase price of $20,400 was paid by the taxpayer. The deed of trust was neither executed nor assumed by the taxpayer, although the property was purchased subject to the deed of trust. During the taxable years 1931 through 1934, taxpayer took depreciation on the property at the rate of $500 per year. (R. 12.)

When the taxpayer purchased the property it was being rented for $160 per month. Shortly thereafter property values in the neighborhood deteriorated and the tenant refused to continue to pay $160 per month. In August 1931 taxpayer leased the property for two years at $135 per month. This amount of rent was collected until February 1933 and was thereafter reduced to $115 per month, which amount was collected until the end of the lease, in September 1933. After the lease terminated the taxpayer was never able to secure another tenant and the property became vacant. (R. 12.)

The note for $15,000 which was secured by the deed of trust on the property became due on Janu-

ary 27, 1935. At that time business conditions had so completely changed in the locality that the taxpayer's equity in the property was of no value. Taxes for the year 1934, amounting to $380.04, were past due and unpaid. The taxpayer determined to abandon the property and permit the holder of the deed of trust to foreclose. (R. 12.)

Foreclosure took place on March 16, 1935, and the property was purchased for the sum of $10,000. The property was not purchased directly or indirectly by the taxpayer, nor was it purchased by the holder of the mortgage. No redemption proceedings were instituted by the taxpayer. By reason of the foreclosure sale the taxpayer's equity was completely wiped out. (R. 12–13.)

In his income tax return for the year 1935 the taxpayer claimed the full loss of $20,400, less $2,000 depreciation. The Commissioner limited the loss to $2,000 pursuant to Section 117 of the Revenue Act of 1934, and determined a deficiency in the amount of $1,589.83 (R. 13). The Board of Tax Appeals overruled the Commissioner's determination (R. 13), but the court below reversed and remanded the case with directions to redetermine the deficiency in the amount of the Commissioner's determination (R. 29).

ARGUMENT

In *Helvering* v. *Hammel,* 311 U. S. 504, and *Electro-Chemical Co.* v. *Commissioner,* 311 U. S. 513, this Court decided that losses arising from

foreclosure sales are capital losses. In the court below, petitioner sought to avoid the application of those cases by urging that he had abandoned the property prior to the foreclosure. The Circuit Court of Appeals held that at best there had been a mere purpose to abandon the property which was ineffective without some affirmative act indicating repudiation of ownership.

In this Court, petitioner seeks to avoid the application of the *Hammel* and *Electro-Chemical* cases by contending, not that there was an abandonment, but that the loss did not result from the foreclosure sale because the property had become worthless prior to the foreclosure proceedings. This contention disregards the rule that losses must be established by identifiable events occurring during the taxable year. It also ignores the conclusion in the *Hammel* opinion that in the practical application of the Revenue Acts the sale is the means adopted for determining the amount of the capital gain or loss.

Insofar as *Commissioner* v. *Freihofer,* 102 F. (2d) 787 (C. C. A. 3), lends support to petitioner's position, it must be regarded as out of harmony with, if not overruled by, the *Hammel* decision and by *Helvering* v. *Nebraska Bridge Supply & Lumber Co.,* 312 U. S. 666, reversing *per curiam* 115 F. (2d) 288.

The reference in *Commissioner* v. *Coggan,* 119 F. (2d) 504 (C. C. A. 1), now pending on petition

for writ of certiorari, No. 317, present Term, to a deduction for worthlessness prior to a sale is of no aid to petitioner. The passage quoted by petitioner (Pet. 8) refers to a deduction for worthless stock, which is governed by very different considerations than are applicable in the case of real estate. Moreover, the distinction there made between worthless stock and a worthless equity in stock which still retains some value is equally applicable here, since the property itself had not become worthless.

There is no conflict with *Commissioner* v. *Hoffman,* 117 F. (2d) 987 (C. C. A. 2). While that case allowed a loss upon the abandonment of real estate, petitioner's claim of abandonment was adequately disposed of by the court below and is not relied on here. Petitioner now claims a loss on the ground that the property became worthless prior to the foreclosure sale, not on the ground that he had abandoned it prior to that time.

Schmidlapp v. *Commissioner,* 96 F. (2d) 680 (C. C. A. 2), allowed a deduction, as an ordinary loss, of the value of stock which had become worthless, despite a later public auction of the shares. But it is doubtful whether the same rule is applicable to real estate (cf. *Wieboldt* v. *Commissioner,* 113 F. (2d) 384 (C. C. A. 7)), particularly where, as here, the real estate, as distinguished from the taxpayer's equity, had not become worthless. And if the *Schmidlapp* decision were held appli-

cable to the situation here presented, it would, like the *Freihofer* case, have to be regarded as out of harmony with, if not overruled by, the *Hammel* and *Nebraska Bridge Supply* cases, *supra*.

CONCLUSION

The holding of the Circuit Court of Appeals in this case is correct and involves no conflict of decisions. It presents no problem requiring the consideration of this Court. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted.

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SEPTEMBER 1941.

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